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No. 93-____

In The Supreme Court of the United States

October Term, 1993

NCR Corporation,
Petitioner,

v.

South Carolina
Department of Revenue and Taxation,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of South Carolina

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case raises the same two questions presented by the petition for certiorari filed by petitioner in *NCR Corporation v. Taxation and Revenue Department of the State of New Mexico,* No. 93-541, which is currently pending before the Court:

1. Whether the prohibition of the Foreign Commerce Clause against state taxes that inevitably cause international multiple taxation precludes a state from taxing a corporation's foreign source interest and royalties on which the corporation has already paid taxes on an unapportioned basis to foreign countries.

2. Whether the fair apportionment requirement of the Commerce and Due Process Clauses precludes a state from including in a corporation's apportionable tax base income received from its unitary subsidiaries without taking account of the subsidiaries' income-producing factors in the apportionment formula.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, respondent was referred to as the South Carolina Tax Commission. However, effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

RULE 29.1 STATEMENT

Petitioner NCR Corporation is a wholly-owned subsidiary of American Telephone & Telegraph Company, which itself has no parent corporation. Petitioner's subsidiaries, other than wholly-owned subsidiaries, are as follows:

NCR Ghana Limited

NCR Japan, Ltd.

NCR (Nigeria) Limited

NCR (Thailand) Ltd.

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DEPARTMENT OF REVENUE AND TAXATION,
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Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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PETITION FOR A WRIT OF CERTIORARI

NCR Corporation respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of South Carolina in this case.

OPINIONS BELOW

The second opinion of the Supreme Court of South Carolina in this case (*"NCR II"*) (App. A at 1a-7a) is not yet reported. The supplemental order on remand of the Court of Common Pleas of Richland County, South Carolina (App. B at 8a-9a) is unreported. The order on remand of the Court of Common Pleas of Richland County, South Carolina (App. C at 10a-25a) is unreported. The first opinion of the Supreme Court of South Carolina in this case (*"NCR I"*) (App. D at 26a-41a) is

reported at 304 S.C. 1, 402 S.E.2d 666 (1991). The final order of the Court of Common Pleas of Richland County, South Carolina (App. E at 42a-67a) is unreported. The Finding of the South Carolina Tax Commission (App. F at 68a-72a) is unreported.

JURISDICTION

The judgment of the Supreme Court of South Carolina in *NCR I*, which decided the first question NCR presents here (*see* p. i *supra*), was entered on February 4, 1991. The court in *NCR I* remanded the case to determine whether NCR was entitled to relief with respect to the second question NCR presents here (*see* p. i *supra*). The judgment of the Supreme Court of South Carolina in *NCR II*, which decided this second question, was entered on December 13, 1993. The now final judgment of the South Carolina Supreme Court carries with it all federal issues properly raised in this case. *Urie v. Thompson*, 337 U.S. 163, 172-73 (1949); *Louisiana Navigation Co. v. Oyster Comm'n*, 226 U.S. 99, 102 (1912). The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of the South Carolina statutes are set forth in App. G at 73a-78a.

STATEMENT

This case—like *NCR Corporation v. Taxation and Revenue Department of the State of New Mexico*, No. 93-541 (petition for certiorari pending)—raises two issues of great significance for state taxation of multistate and multinational corporations. Both arise out of the fact that South Carolina, like most other states, includes in a corporate taxpayer's apportionable tax base income the taxpayer receives from its unitary foreign subsidiaries without taking into account the foreign subsidiaries' income-producing factors in apportioning such income. When, as in this case, the income is received in the form of royalties and interest from foreign subsidiaries, and the recipient has already been taxed on the full amount of that income by foreign countries on an unapportioned basis, the state's failure to provide for "factor representation" of the subsidiaries' factors in the parent's apportionment formula inexorably leads to international multiple taxation. The result is difficult to square with this Court's Foreign Commerce Clause jurisprudence barring state taxes that "inevitably" cause international multiple taxation. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979).

The state's failure to provide for "factor representation" also raises a critical issue under the Court's "domestic" Commerce and Due Process Clause jurisprudence. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court explicitly left open the question whether the inclusion of income from unitary subsidiaries in the parent's apportionable tax base required that the subsidiaries' factors be reflected in the parent's apportionment formula. *Id.* at 441 n.15. Justice Stevens, who did address this question, observed that unless the subsidiaries' factors were reflected in the taxpayer-parent's apportionment formula, "the inclusion of earnings attributable to those corporations . . . will inevitably cause [the taxpayer-parent's] . . . income to be overstated." *Id.* at

461 (Stevens, J., dissenting) (footnote omitted). This case provides the Court with an opportunity to resolve this issue, which has spawned division and confusion in the state courts.

1. NCR's Business

The facts of this case are not in dispute.[1] Petitioner NCR Corporation is a Maryland corporation with its corporate headquarters and principal place of business in Dayton, Ohio. NCR is engaged in the manufacture and sale of business information processing systems, including cash registers, automated bank tellers, and computers. NCR conducts "an integrated unitary business nationwide and worldwide." App. D at 28a n.1. All phases of NCR's worldwide business are conducted partly within and partly without South Carolina.

In foreign countries, NCR conducts its business directly through branch offices and indirectly through subsidiary corporations. During the years at issue (1981-83), NCR had approximately 18 branch offices and 75 foreign subsidiaries doing business in over 150 foreign countries. With one exception, the foreign subsidiaries were 100 percent owned by NCR. None of the foreign subsidiaries did any business within South Carolina.

2. NCR's Royalty and Interest Income Received from Its Unitary Foreign Subsidiaries

NCR received substantial royalty and interest income from its unitary foreign subsidiaries. The royalties arose from patents and licensing agreements under which NCR's foreign subsidiaries were entitled to manufacture and sell business machines in various foreign countries. The interest arose from various loans that NCR made to its foreign subsidiaries. For the years in question, the

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[1] Except as otherwise indicated, the following statement of facts is drawn primarily from the South Carolina Supreme Court's statement of facts in *NCR I*. App. D at 27a-29a.

amounts of royalties and interest NCR received from its foreign subsidiaries were as follows:

Year	Royalties	Interest
1981	$34,167,013	$18,331,361
1982	$40,906,977	$16,839,715
1983	$52,095,171	$ 6,010,449

Record on Appeal in *NCR II* at 160.[2]

During the years at issue, NCR paid $15,484,917 in income taxes to foreign countries upon the royalties and interest in question. Tr. of Record in *NCR I* at 211.[3] These foreign income taxes were unapportioned levies on the full value of all royalty and interest amounts received by NCR from its foreign subsidiaries. App. D at 27a. At the same time that foreign countries imposed unapportioned foreign income taxes on these royalties and interest, South Carolina imposed an apportioned tax upon the identical royalties and interest. App. D at 28a-29a.

3. South Carolina's Taxing Scheme

South Carolina imposes its corporate income tax upon the "net income" of every domestic corporation and every foreign corporation doing business in the state. S.C. Code Ann. § 12-7-230 (Law. Co-op. 1976 & Supp. 1993) (App. G at 73a). During the years at issue, a corporation's "net income" was defined as its gross income less deductions allowed for South Carolina tax purposes. *Id.* § 12-7-600. Corporations whose principal busi-

[2] The amounts set forth above differ slightly from those cited by the court below in *NCR I* (*see* App. D at 28a), because the amounts set forth in the text above represent gross royalties and interest paid to NCR whereas the amounts set forth in *NCR I* represent taxable royalties and interest net of related expenses.

[3] The foreign income taxes imposed upon NCR were in addition to the taxes that NCR's foreign subsidiaries paid to foreign countries on their own income. App. D at 27a.

ness was manufacturing and selling, and who derived income from interstate activities, were required to apportion, on the basis of a three-factor formula, all income that was not specifically allocated.[4] *Id.* §§ 12-7-230, 12-7-1140 to 12-7-1170 (App. G at 73a-76a). Under this formula, the taxpayer's income was apportioned to South Carolina by the average ratio of its property, payroll and sales in South Carolina to its property, payroll, and sales everywhere. *Id.* § 12-7-1140 (App. G at 75a-76a).

4. The Assessment

In filing its South Carolina tax returns for the years at issue, NCR took two alternative positions. First, it excluded from its taxable net income the royalties and interest it received from its foreign subsidiaries (App. E at 48a) on the theory that, under the Foreign Commerce Clause, South Carolina could not include the royalties and interest in NCR's apportionable tax base because the full amount of such income was subject to tax on an unapportioned basis by foreign countries.[5] South Carolina's taxation of even an apportioned share of such income, NCR maintained, would inevitably lead—and in

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[4] Although South Carolina does not use the familiar distinction between apportionable "business" income and allocable "nonbusiness" income that is employed in the Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 331 (1985), its statutes follow a similar pattern by allocating various classes of income (including royalties and interest "not connected with" the business of the taxpayer) and apportioning the taxpayer's remaining net income (including royalties and interest received from unitary subsidiaries, which are at issue here). S.C. Code §§ 12-7-1120 to 12-7-1140 (Law. Co-op. 1976 & Supp. 1993) (App. G at 74a-76a).

[5] NCR also based its position on the theory that a tax on its foreign source royalties and interest prevented the United States from "speaking with one voice" in regulating foreign commerce. See App. E at 53a-54a. NCR does not press this argument before this Court.

fact had led—to international multiple taxation in violation of *Japan Line*. Alternatively, NCR contended that, if the disputed income were includable in NCR's apportionable South Carolina tax base, then, under both the Commerce and Due Process Clauses, the income-producing factors of NCR's foreign subsidiaries should be reflected in the formula employed to apportion NCR's income. App. E at 57a. Upon audit, the South Carolina Tax Commission (the "Commission")[6] rejected both NCR's Foreign Commerce Clause and its "factor representation" arguments.[7] Following a hearing, the Commission denied NCR's protest and issued an assessment of taxes and interest for income tax years 1981-83 (and for license fee years 1982-84) of $499,007.[8]

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[6] Effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

[7] In filing its 1981 return, NCR excluded its foreign royalties and interest from the apportionable tax base and argued for "factor representation" in the alternative. App. E at 44a. In filing its 1982 and 1983 returns, NCR included the foreign royalties and interest in the apportionable tax base while also including the foreign subsidiaries' payroll, property, and sales in its apportionment formula. *Id.* NCR renewed both of these positions for all of the years at issue when it challenged the tax assessment in the Court of Common Pleas, *see infra* p. 8, which reviews tax protests *de novo*. *See* J. von Lehe & F. Boyle, *South Carolina Income Taxation* I-4 (3d ed. 1987).

[8] Tr. of Record in *NCR I* at 3-4. Of the total assessment for taxes and interest, $492,982 was attributable to the income tax (*id.* at 3), and $6,025 was attributable to the license tax (*id.*), which is an annual tax based on capital employed in South Carolina. S.C. Code Ann. § 12-19-70 (Law. Co-op. 1976 & Supp. 1993) (App. G at 76a-77a). The license tax base includes NCR's investments in its foreign subsidiaries but is apportioned by the same formula prescribed for the income tax (*id.* § 12-19-80 (App. G at 77a-78a)), which takes no account of such subsidiaries. NCR's constitutional objections to the South Carolina income tax apportionment formula are therefore equally applicable to the license fee apportionment formula, and its petition for review of the

5. The Decision Below

a. Court of Common Pleas (*NCR I*)

NCR filed a timely complaint in the South Carolina Court of Common Pleas, challenging the assessment on the grounds, among others, that the tax violated the Commerce and Due Process Clauses. Tr. of Record in *NCR I* at 6. The court rejected NCR's Foreign Commerce Clause contention that the South Carolina tax resulted in inevitable international multiple taxation, even though NCR's royalties and interest had already been taxed abroad. It reasoned that "[t]he mere fact that interest and royalty income are [*sic*] included in the preapportionment base does not mean that South Carolina is, in fact, taxing that specific income." App. E at 49a The court also rejected NCR's alternative Commerce and Due Process claim for "factor representation." It declared that "even if a 65.8% increase" (*id.* at 64a) in NCR's tax could have been attributed to the failure to include the foreign subsidiaries' factors in NCR's apportionment formula, "such is not a sufficient increase to violate Due Process or Interstate Commerce." *Id.*

b. Supreme Court of South Carolina (*NCR I*)

The Supreme Court of South Carolina affirmed in part and remanded in part. App. D at 41a. With respect to NCR's Foreign Commerce Clause claim, the court acknowledged that many of the foreign countries in which NCR's subsidiaries do business "impose an unapportioned tax on NCR on the full value of all royalty and interest amounts earned by NCR and paid to it by its foreign subsidiaries." *Id.* at 27a. It also recognized that South Carolina's taxation of even an apportioned share of these royalties and interest would result in "actual double tax-

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judgment below is directed to both taxes. Because of the relative insignificance of the license fee, however, no further reference will be made to it in this petition.

ation" (*id.* at 35a), just as California's apportioned tax resulted in multiple international taxation in *Japan Line*. Consequently, it conceded that "*Japan Line* appears to support NCR's position here" (*id.* at 32a)—at least if it is "[r]ead in isolation." *Id.*

The court nevertheless found *Japan Line* distinguishable from the instant case on the same grounds that this Court had distinguished *Japan Line* in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). App. D at 35a. In *Container*, the Court sustained California's worldwide unitary combined reporting method as applied to a United States multinational corporation over the objection, *inter alia*, that it resulted in multiple international taxation in violation of the strictures of the Foreign Commerce Clause articulated in *Japan Line*. In addressing this claim, the Court in *Container* observed that "the double taxation in this case, although real, is not the 'inevitabl[e]' result of the California taxing scheme." *Container*, 463 U.S. at 188 (quoting *Japan Line*, 441 U.S. at 447). It also observed that the tax in *Container* was on income and fell on a domestic corporation, whereas the tax in *Japan Line* was on property and fell on a foreign corporation. *Container*, 463 U.S. at 187-89.

The South Carolina Supreme Court found that "[t]he same distinguishing factors exist which make *Japan Line* inapplicable in the instant case." App. D at 35a. Thus, it was "unconvinced that double taxation is 'inevitable' under the South Carolina taxing scheme" (*id.*), although it did not explain why South Carolina's apportioned tax on the royalties and interest did not inevitably lead to multiple taxation when those royalties and interest had already been taxed in full abroad. The court also noted that "[t]his is not a property tax case" (*id.*) and that "the tax here falls on a domestic corporation, not a foreign corporation." *Id.* The court did not indicate, however, how these "distinguishing factors" of *Container* served to differentiate *Japan Line* from the instant case

with regard to the question of "inevitable" multiple taxation.

While rejecting NCR's Foreign Commerce Clause claim, the court did find merit in NCR's contention that South Carolina could not constitutionally include the royalty and interest income that NCR derived from its foreign subsidiaries in NCR's apportionment formula without also including the subsidiaries' factors in NCR's apportionment formula. It observed that "South Carolina's taxing scheme is not ideally fair" (App. D at 39a) because the royalties and interest in question were earned, at least "[t]o a degree" (*id.*), in foreign countries, yet South Carolina took no account in the apportionment formula of the out-of-state factors that generated this income. The court thus recognized the principle that inclusion of income from subsidiaries in the parent's apportionable tax base " 'should be balanced by some changes in the formula denominator.' " *Id.* at 39a (citation omitted). Nevertheless, because the court believed that NCR would be entitled to an adjustment in the apportionment formula only if it could demonstrate that failure to provide for such an adjustment would result in "gross distortion" (*id.* at 40a), the court remanded the case to the Court of Common Pleas for a "refactoring of the formula, considering in the formula . . . the proportionate measure . . . of the foreign subsidiaries' property, payroll, and sales which generated the NCR income." *Id.* The Supreme Court of South Carolina instructed the Court of Common Pleas to compare NCR's tax liability with and without "factor representation" and to grant relief only if there were a "gross disparity . . . of constitutional proportions" (*id.*) between the two amounts.

c. Court of Common Pleas (*NCR II*)

On remand, the Court of Common Pleas found that including a proportionate share of the subsidiaries' property, payroll, and sales in NCR's apportionment factors reduced NCR's South Carolina tax liability as follows:

	1981	1982	1983
Old tax	$190,879	$264,541	$426,600
New tax	$138,001	$216,977	$344,948
Difference	$ 52,878	$ 47,564	$ 81,652

App. C at 21a. The court further found the resulting percentage increases from failing to permit "factor representation" were as follows:

	1981	1982	1983
Difference	$ 52,878	$ 47,564	$ 81,652
New tax	$138,001	$216,977	$344,948
% increase	38.3%	21.9%	23.6%

Id. The average increase for the three tax years at issue was 27.9 percent. *Id.*[9]

Despite the existence of a systematic overstatement of NCR's taxes of, on average, some 28 percent as a result of failing to account for the subsidiaries' factors in NCR's apportionment formula, the court concluded that this did not amount to "[g]ross distortion of a constitutional magnitude." *Id.* at 23a. Moreover, the trial court explicitly rejected NCR's argument that, regardless of the size of the distortion percentage, the state's formula was unconstitutional because it " 'is inherently unfair, [and] inevitably results in taxation of substantial extraterritorial values on an ongoing basis . . . .' " App. B at 9a (quoting Plaintiff's Memorandum of Law at 2).

d. Supreme Court of South Carolina (*NCR II*)

The Supreme Court of South Carolina affirmed. Evidently viewing NCR's argument regarding the inherent

[9] For purposes of this petition, NCR is not contesting the validity of the "re-factoring" methodology employed by the Court of Common Pleas, although NCR challenged the validity of that method before the court. Significantly, however, the trial court found that NCR's "burden of showing a 'gross distortion' " (App. C at 24a) of constitutional magnitude was so heavy that, even assuming NCR's methodology was correct and the average distortion for the three years was 51 percent, *id.*, NCR would not have established a constitutional violation.

unfairness of the state's formula as constitutionally irrelevant, the court simply ignored it. Instead, relying on this Court's opinion in *Container*, the court dismissed NCR's claim of a right to "factor representation" in a few brief paragraphs. App. A at 5a-7a. The court observed that this Court in *Container* had rejected a constitutional challenge to an apportioned tax on the ground that a 14 percent increase in taxable income fell " 'within the substantial margin of error inherent in any method of attributing income among the components of a unitary business.' " *Id.* at 6a (quoting *Container*, 463 U.S. at 184). It viewed this Court's opinion in *Container* as establishing an "acceptable" (*id.*) level of distortion and noted that "[o]ther state courts have upheld similar or larger margins of error." *Id.* at 6a-7a. And it concluded that the 28 percent overtaxation of NCR resulting from the failure to provide for "factor representation" did not rise to the level of a "gross disparity" (*id.* at 7a) violating constitutional strictures.

REASONS FOR GRANTING THE PETITION

The judgment of the Supreme Court of South Carolina warrants review by this Court for three compelling reasons. First, the court's decision condoning international multiple taxation is incompatible with this Court's Foreign Commerce Clause jurisprudence and, if left undisturbed, would undermine essential restraints on state tax power. At the very least, this Court's guidance is needed to clarify the distinction between taxes that are constitutionally intolerable under *Japan Line* and those that can survive constitutional scrutiny under *Container*. Second, the state court's reliance on a gross distortion test to deny NCR's right to representation of its unitary subsidiaries' factors in its apportionment formula, despite the inclusion in NCR's apportionable tax base of income earned by those factors, disposed of a critical issue that this Court explicitly left open in *Mobil* and has created a conflict among state courts of last resort. The Court should

address this issue and resolve the conflict. Third, the issues of both international multiple taxation and "factor representation" present recurring questions of profound practical importance that merit plenary consideration in their own right.

I. THE STATE COURT'S DECISION CONDONING INTERNATIONAL MULTIPLE TAXATION THAT INEVITABLY RESULTS FROM SOUTH CAROLINA'S TAXING SCHEME CANNOT BE RECONCILED WITH THIS COURT'S FOREIGN COMMERCE CLAUSE JURISPRUDENCE

In *Japan Line*, this Court held that the Foreign Commerce Clause barred a state from imposing a fairly apportioned personal property tax on cargo containers that had been taxed on an unapportioned basis abroad. Although the tax would have passed muster under the Court's Interstate Commerce Clause doctrine, 441 U.S. at 445-46, the Court held that the tax violated the more exacting demands of the Foreign Commerce Clause. Under the Foreign Commerce Clause, "a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation." *Id.* at 451. In addition, a court must determine "whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* The Court observed that "[i]f a state tax contravenes *either* of these precepts, it is unconstitutional under the Commerce Clause." *Id.* (emphasis supplied).

As the South Carolina Supreme Court recognized, if *Japan Line* controls this case, it plainly "appears to support NCR's position here." App. D at 32a. Just as Los Angeles County in *Japan Line* sought to subject the taxpayer to an apportioned tax on property that a foreign country had taxed on an unapportioned basis, so, too, in this case South Carolina seeks to subject NCR to an apportioned tax on income that foreign countries have already taxed on an unapportioned basis. *Id.* at 27a-29a.

In an effort to deflect the force of this analogy, the state court relied on *Container*, which concerned California's apportioned income tax on the combined income of a multinational group of corporations. The taxpayer challenged the tax on the ground that, when considered in conjunction with taxes imposed on such income by foreign countries, California's levy subjected the income to international multiple taxation in violation of the Foreign Commerce Clause. In sustaining the tax, this Court found that the international multiple taxation it had condemned in *Japan Line* was constitutionally tolerable in *Container* principally because the double taxation in *Container* "although real, is not the 'inevitabl[e]' result of the California taxing scheme." *Container*, 463 U.S. at 188 (quoting *Japan Line*, 441 U.S. at 447).[10]

The state court's reliance on *Container* is misplaced. The multiple taxation in *Container* was not "inevitable" because it resulted from two different methods of dividing the tax base, which was comprised of the worldwide income of Container and its subsidiaries. California employed formulary apportionment as a means of dividing this tax base, whereas other countries used separate accounting as a means of dividing this tax base. "Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case." *Container*, 463 U.S. at 188.

In *Japan Line* and the instant case, by contrast, there was no effort by the foreign taxing jurisdictions to divide the tax base—the property in *Japan Line*, the royalties and interest here. Rather, the taxing jurisdictions allocated 100 percent of the tax base to themselves. Consequently,

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[10] The Court also distinguished *Japan Line* on the ground that it involved a property tax rather than income tax and that the taxpayer was foreign rather than domestic. *Id.* at 187-89. But these factors were largely subsumed within the Court's analysis of whether the international multiple taxation in *Container* was "inevitable" and hence intolerable.

when Los Angeles County or South Carolina sought to impose an apportioned tax on the same tax base, multiple taxation was "inevitable." Because foreign countries subjected 100 percent of the relevant base to tax, *any* apportioned tax imposed by another jurisdiction would result in multiple taxation. In short, we are not dealing here, as the Court was in *Container*, with two different methods of "divid[ing] the pie." *Id.* Rather, here (as in *Japan Line*) the entire pie has been subjected to tax by foreign jurisdictions, which leaves the states no room to tax even an apportioned slice.

There is a further point of distinction between *Container* and the instant case that accounts for the inevitability of the multiple taxation here. In *Container*, the combined income *and the combined factors* of Container and its unitary foreign subsidiaries were considered in determining the income that was properly attributable to California. Hence there was no certainty that, by including the foreign subsidiaries' income in the apportionable tax base, California would in fact *tax* such income. Rather, as a result of the inclusion of the foreign subsidiaries' factors in the apportionment formula, the income apportioned to California could decrease, increase, or remain the same.[11]

Here, by contrast, while the royalties and interest that NCR derived from its unitary foreign subsidiaries were included in its South Carolina apportionable tax base, the factors of those subsidiaries that earned the income were ignored in apportioning the income to South Carolina.

[11] When a state considers both the income and factors of foreign subsidiaries in the apportionment, two things happen: first, the apportionable tax base *increases*, because of the inclusion of the foreign subsidiaries' income; second, the apportionment percentage *decreases*, because the foreign subsidiaries' property, payroll, and sales add to the denominators, but not the numerators, of the corporation's apportionment factors for the taxing state. Thus, depending on the relative impact of these two changes, the income apportioned to the state will decrease, increase, or remain the same.

Consequently, there was dead certainty that South Carolina would *tax* a portion of every dollar of royalties and interest that NCR received from its foreign subsidiaries,[12] and, accordingly, dead certainty that there would be international multiple taxation when such income was taxed on an unapportioned basis by foreign countries.

The court below was simply wrong in failing to recognize that South Carolina's taxing scheme gave rise to inevitable multiple taxation. Although it properly recognized that there was double taxation in this case, App. D at 27a-29a, the court provided no satisfactory explanation why such double taxation was not "inevitable" or why *Container* was controlling. Without further analysis, it declared simply that it was "unconvinced that double taxation is 'inevitable' under the South Carolina taxing scheme." App. D at 35a. Perhaps hedging its bets, the court went on to suggest that "[e]ven if we were convinced that the tax resulted in inevitable double taxation, we doubt, in light of the other facts clearly distinguishing this case from *Japan Line*, that the taxing scheme should be struck down." *Id.* at 35a n.4. But the court cited no authority—and we know of none—for the proposition that such "other facts" could ever justify inevitable multiple taxation of foreign commerce.

Finally, insofar as there are differences between this case, *Japan Line*, and *Container*, they underscore the need for the Court's consideration of this controversy. *Japan Line* articulated the principles limiting state taxation of foreign commerce, but, in contrast to this case, in the context of a property tax rather than an income tax. *Container* applied those principles to an income tax, but, in contrast to this case, in the context of a worldwide combined tax base where the subsidiaries' factors were fully represented. This case provides the Court with an oppor-

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[12] When income is added to the apportionable tax base without modifying the factors employed to apportion such income, the necessary result is to tax a portion of such income. *See* note 11 *supra*.

tunity to apply *Japan Line*'s principles to a tax on income which has been taxed by foreign countries but with respect to which "factor representation" has been denied. The Court's review is necessary to delineate these principles in a manner that displays greater sensitivity to Foreign Commerce Clause concerns than did the court below and to provide guidance for state courts regarding the meaning of "inevitable" multiple taxation.

II. THE STATE COURT'S RULING THAT INCOME FROM UNITARY SUBSIDIARIES MAY BE INCLUDED IN THE APPORTIONABLE TAX BASE WITHOUT INCLUDING THE SUBSIDIARIES' FACTORS IN THE APPORTIONMENT FORMULA DISPOSES OF THE ISSUE THAT THIS COURT LEFT OPEN IN *MOBIL* AND CREATES A CONFLICT AMONG STATE COURTS OF LAST RESORT

In *Mobil,* this Court held that a state could include within the apportionable tax base of a nondomiciliary corporation the intangible income that it received from its subsidiaries as long as the taxpayer and its subsidiaries were engaged in a unitary business. Although the taxpayer in *Mobil* had resisted that conclusion, it claimed that if the income it received from its subsidiaries was constitutionally apportionable on the theory that it was engaged in a unitary business with its subsidiaries, then such income should have been apportioned under a method that included the subsidiaries' factors in the apportionment formula.

The Court declined to reach this question because it was not timely raised. *Mobil,* 445 U.S. at 441 n.15; *see also id.* at 449. Justice Stevens, however, did address the question in his dissent, where he declared:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable

> tax base will inevitably cause [the payee's in-state] income to be overstated.

Id. at 461 (Stevens, J., dissenting). The Court has subsequently expressed similar sentiments by observing that the fair apportionment requirement demands that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container,* 463 U.S. at 169. *See also id.* at 168 n.5 (recognizing Justice Stevens' views in *Mobil*).

The logic of Justice Stevens' dissent in *Mobil* is irrefutable. If a state fails to account for the factors of a taxpayer's out-of-state subsidiaries that generate apportionable income, the state will inevitably attribute to itself too much of the taxpayer's income. Since the factors outside the taxing state are disregarded, the consequence is to apportion all of the income by reference only to those factors that are taken into account, thereby over-assigning income to those factors. In other words, the formula gives credit to the taxing state for activities occurring elsewhere by disregarding the factors associated with these out-of-state activities.

In holding that South Carolina could include NCR's royalties and interest received from its unitary foreign subsidiaries in NCR's apportionable tax base while denying NCR the right to include in its apportionment formula the subsidiaries' factors that generated the income, the court below has improperly relied on *Container*'s "gross distortion" test to sustain a theoretically indefensible formula. In so doing, the court has disposed of the issue that this Court left open in *Mobil* and has created an irreconcilable conflict with decisions of other state courts. The Supreme Court of Maine and the Wisconsin Court of Appeals have each recognized a taxpayer's right to "factor representation" when income received from subsidiaries is included in the taxpayer's apportionable tax base. *Tambrands, Inc. v. State Tax Assessor,* 595 A.2d 1039 (Me. 1991); *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue,* 143 Wis. 2d 533, 422 N.W.2d 629

(Ct. App. 1988). The Supreme Court of Rhode Island has recognized a similar principle with respect to partnership income received by a corporation. *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987). Other courts, however, have agreed with the South Carolina Supreme Court that "factor representation" is not constitutionally required, at least in the absence of a demonstration by the taxpayer that failure to provide for "factor representation" produces a "grossly distorted result." *NCR Corp. v. Taxation and Revenue Dep't*, 115 N.M. 612, 856 P.2d 982 (Ct. App. 1993), *petition for cert. filed*, 62 U.S.L.W. 3289 (U.S. Oct. 5, 1993) (No. 93-541); *Ashland Pipe Line Co. v. Marx*, 623 So. 2d 995, 1004 (Miss. 1993); *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988); *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn.), *cert. denied*, 493 U.S. 848 (1989).[13]

In *Tambrands*, the question was whether Maine could constitutionally include dividend income that the taxpayer received from its unitary foreign subsidiaries in the taxpayer's apportionable tax base without including the subsidiaries' factors in the taxpayer's apportionment formula. Relying on this Court's decision in *Container* (595 A.2d at 1044-45) and on Justice Stevens' dissent in *Mobil* (*id.* at 1044 n.9), the Maine Supreme Court concluded that the "ineluctable result" of including the income derived from the taxpayer's unitary foreign subsidiaries' income in the apportionable tax base while excluding their factors from the formula "is that more of the business activity of the unitary business is attributed to Maine than is the actual case." *Id.* at 1044. The court concluded:

> Maine cannot, under the fairness principles of the due process clause requiring that the income it taxes be rationally related to values connected to the taxing

[13] When this Court denied certiorari in the Minnesota *NCR* case, the *Tambrands* case had not yet been decided.

> state, include in Tambrands' "apportionable tax base income from its . . . affiliates operating abroad . . . [and] apportion such income by factors reflecting only [Tambrands' domestic] operations." W. Hellerstein, *Dividing the State Corporate Income Tax Base: Developments in the Supreme Court and Congress*, appearing in *The State Corporation Income Tax* 293 (C. McLure, Jr. ed. 1984).

Id. (brackets in original).

In *American Tel. & Tel.*, the question was whether Wisconsin could constitutionally include dividend and interest income that the taxpayer received from its unitary subsidiaries in the taxpayer's apportionable tax base without including either the subsidiaries' property or, alternatively, the value of the taxpayer's investment in its subsidiaries, in the property factor of the taxpayer's apportionment formula. The Wisconsin Court of Appeals acknowledged that this Court had failed to address the merits of this issue in *Mobil* (143 Wis. 2d at 548, 422 N.W.2d at 635), but noted that commentators had recognized the force of the constitutional attack leveled at

> apportionment formulas which allegedly give insufficient weight to the sales, property and payroll of subsidiaries which make dividend, interest, royalty, and other payments to the parent corporation which are included in the taxing state as income subject to apportionment.

143 Wis. 2d at 549, 422 N.W.2d at 635. The court concluded that the inclusion in AT&T's apportionable tax base of dividends and interest it received from its unitary subsidiaries without adjustment of the apportionment formula's property factor to reflect the subsidiaries' contribution to the production of that income was constitutionally impermissible. "[T]he apportionment formula used by the department does not reflect a reasonable sense of how AT&T's income is generated and taxes value earned outside the borders of Wisconsin, contrary

to . . . the due process and commerce clauses of the United States Constitution." 143 Wis. 2d at 551, 422 N.W.2d at 636.

In *Homart*, the question was whether Rhode Island could include a nondomiciliary corporation's partnership income in the corporation's apportionable tax base without reflecting the partnerships' factors in the corporation's apportionment formula. In holding that "factor representation" was required, the Rhode Island Supreme Court declared:

> The inclusion of this income in Homart's net-income calculation for apportionment purposes necessarily requires that the payroll, property, and receipt factors that gave rise to it be included in the apportionment equation also. Otherwise, the net income is subject to an apportionment ratio that reflects only Homart's in-state and everywhere business activity when, in fact, this income did not arise from Homart's corporate business activity but instead arose out of the partnerships' business activities that were not reflected in the apportionment ratio.

Homart, 529 A.2d at 121.

Indeed, even those courts that have concluded, along with the court below, that "factor representation" is unnecessary in the absence of proof of "gross distortion," have recognized the unfairness of including income from unitary subsidiaries in the apportionable tax base without adjusting the apportionment formula to reflect the subsidiaries' income-producing activities. Thus the court below recognized that "South Carolina's taxing scheme is not ideally fair." App. D at 39a. *See also NCR Corp. v. Comptroller of the Treasury*, 313 Md. at 151, 544 A.2d at 780-81. In addition to the conflict that these decisions create with *Tambrands*, *American Tel. & Tel.*, and *Homart*, these courts' reliance on the good-enough-for-government-work defense that a theoretically defective apportionment can be justified as long as the resulting distortion is not too great raises a question that is it-

self worthy of this Court's review. *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920) (apportionment formula may be struck down as "inherently arbitrary"); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 133 (1931) (apportionment formula may be struck down as "intrinsically arbitrary").

The pernicious consequences of state courts' reliance on this lack-of-gross-distortion defense are aptly illustrated by this case. The court below explicitly recognized in *NCR I* that NCR's royalties and interest received from its foreign subsidiaries were earned—at least "[t]o a degree" (App. D at 39a)—in foreign countries. It further recognized that, as a result of South Carolina's failure to account for the foreign subsidiaries' factors in NCR's apportionment formula, South Carolina was taxing *on an annual basis* 28 percent more of NCR's income than it was entitled to if South Carolina's apportionment scheme had been "ideally fair." *Id.* at 38a; App. A at 6a.[14] Yet the court, with a perfunctory reference to this Court's decision in *Container*, dismissed this annual, systematic, and substantial overstatement of NCR's income as not amounting to a "gross disparity" (App. A at 7a) of "constitutional proportions." App. D at 40a.

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[14] The systematic overtaxation of NCR resulting from South Carolina's failure to permit "factor representation" is illustrated by NCR's 1981 tax year. By taking into account $32,996,316 of royalty income and $18,304,080 of interest income, the Commission increased apportionable income from $76,478,793 to $127,779,189, an increase of 67 percent. The only adjustment made by the Commission to the apportionment formula was to include the royalty and interest income in the denominator of the sales factor. Since the denominator of the sales factor was nearly $1.9 billion, this adjustment had the negligible effect of decreasing NCR's South Carolina apportionment percent by 0.4 percent. *See* Tr. of Record in *NCR I* at 196, 200. The inexorable consequence of increasing NCR's tax base by more than half, as a result of the inclusion of foreign source royalties and interest, without making a correlative adjustment to the apportionment formula was to permit South Carolina to tax substantial amounts of NCR's income that was earned outside the state.

Decisions in this case and others like it [15] represent a misapplication of this Court's state tax jurisprudence. They routinely cite *Container* for the proposition that the inexorable overtaxation that results from failure to provide "factor representation" is constitutionally "acceptable" (App. A at 6a) as long as it does not approach the 250 percent distortion found intolerable in *Hans Rees*. What these opinions fail to consider, however, is that the "substantial margin of error" standard articulated by *Container* (463 U.S. at 184) was designed to provide states with a constitutional cushion in implementing *theoretically sound* formulas that may on occasion produce results that fall short of perfection.[16] The standard was never designed as a safe harbor for analytically indefensible apportionment regimes like South Carolina's that produce systematic and substantial overtaxation of a corporation's income year after year.

When the South Carolina court's misuse of this Court's opinion in *Container* as a shield for a theoretically indefensible apportionment regime is considered in conjunction with the conflict that it creates with the decisions of other state courts, the need for this Court's guidance is clear.

III. THE ISSUES OF BOTH INTERNATIONAL MULTIPLE TAXATION AND "FACTOR REPRESENTATION" RAISED BY THE DECISION BELOW ARE RECURRING QUESTIONS OF GREAT PRACTICAL IMPORTANCE

Wholly apart from the incompatibility of the state court's decision with this Court's Foreign Commerce

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[15] *E.g., NCR Corp. v. Taxation and Revenue Dep't*; *Ashland Pipe Line*; *NCR Corp. v. Comptroller of the Treasury*.

[16] As noted above (*see supra* pp. 14-15), the apportionment formula at issue in *Container*, which included all of the income *and* all of the factors of the combined unitary group, was theoretically unobjectionable.

Clause precedents and from the conflict that the decision has created with other state courts of last resort, the decision below warrants this Court's review because it presents recurring questions of great practical importance.

The issues raised by this case arise in virtually every state with a corporate income tax. Like South Carolina, the overwhelming majority of states include intangible income that a corporate taxpayer receives from unitary foreign subsidiaries in the taxpayer's apportionable tax base.[17] Like South Carolina, the overwhelming majority of states fail to provide for "factor representation" when such income is included in a taxpayer's apportionable tax base. Indeed, NCR is aware of only two instances in which a state by statute provides for "factor representation" with respect to such income. N.H. Rev. Stat. Ann. § 77-A:3, II(b) (1991) ("factor representation" for dividends from unitary foreign affiliates); Utah Code Ann. § 59-7-303(4) (1992) (same). Consequently, the questions raised by the decision below—both with respect to international multiple taxation and with respect to "factor representation"—are constantly arising in almost every state with a corporate income tax. *See* Brief of *Amicus Curiae* Tax Executives Institute, Inc. in Support of Petitioner, *NCR Corp. v. Taxation and Revenue Dep't*, No.

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[17] The vast majority of states use federal taxable income as the starting point for calculating state taxable income. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 125 (1993). The federal tax base generally includes dividends, interest, and royalties received from foreign affiliates. I.R.C. § 61. Accordingly, unless explicitly excluded, such foreign source income is includable in the apportionable tax base in most states. Although a number of states provide a complete deduction for dividends from foreign affiliates, most provide only a partial deduction or none at all. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 79 (1993) (and paragraphs cited therein). Moreover, only a handful of states exclude foreign source interest or royalties from the state apportionable tax base. *See, e.g.*, Ohio Rev. Code Ann. § 5733.04(I)(2) (Anderson 1991); Va. Code Ann. §§ 58.1-302, 58.1-402(C)(8) (Michie 1991 & Supp. 1993).

93-541 (petition for certiorari pending); Brief of the Commission on State Taxation as *Amicus Curiae* in Support of Petitioner, *id.* These questions have resulted in widespread disputes between taxpayers and state taxing authorities, as illustrated by the cases already cited in this petition and many others that are currently pending in state courts and administrative tribunals.

The amount of taxes at stake in these controversies is enormous. Thousands of taxpayers annually receive billions of dollars in foreign source dividends, interest, and royalties,[18] and much of this income is includable in their state apportionable tax bases.[19] Indeed, NCR's foreign source royalties and interest constituted on average more than 39 percent of its South Carolina tax base. *See* App. E at 43a-44a; Tr. of Record in *NCR I* at 200-02. *See also Mobil*, 445 U.S. at 430 (involving "substantial amounts received as dividends from its subsidiaries and affiliates operating abroad"); *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 112 S. Ct. 2365 (1992) (involving over $10 million of dividends received from unitary foreign subsidiaries).

In view of the large number of taxpayers that are subject to taxing schemes like South Carolina's and the sig-

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[18] In 1986 alone, approximately $5.6 billion of dividends and $3.8 billion of interest, rents, and royalties were paid to large U.S. corporations (*i.e.*, those with total assets of at least $500 million) by their 7500 largest controlled foreign corporations. Internal Revenue Service, Statistics of Income Division, *Compendium of Studies of International Income and Taxes*, Pub. 1267 (9-91), 223. In 1988, 744 of these largest U.S. corporations filed information returns reflecting their holdings in controlled foreign corporations. Internal Revenue Service, *Statistics of Income Bulletin*, Vol. 12, No. 2 (Fall 1992), 71. When one takes account of smaller corporations, the total number of corporations receiving intangible income from foreign subsidiaries is obviously much larger.

[19] Although the foreign source income figures cited in note 18 *supra* include amounts paid by both unitary and nonunitary affiliates, plainly the amounts attributable to unitary subsidiaries are substantial.

nificant amounts of tax dollars involved, the practical importance of this controversy is self-evident.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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